Supreme Court, U. S.
FILED
NOV 17 1980
MICHAEL RODAK, JR. CLERK

NO. 79-1423

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal, Second Appellate District, State of California

---

BRIEF FOR THE APPELLANT

Alan R. Vogeler
(Counsel of Record)
2500 Central Trust Center
201 E. Fifth Street
Cincinnati, OH 45202
(513) 651-6800

Attorney for Appellant, The Western and Southern Life Insurance Company

OF COUNSEL:

Barbara G. Watts
Frost & Jacobs
2500 Central Trust Center
201 E. Fifth Street
Cincinnati, OH 45202

November 14, 1980

QUESTIONS PRESENTED

The questions presented by this appeal are:

1. Do the California constitutional and statutory provisions levying an additional retaliatory tax on some foreign insurance companies but not on domestic insurance companies and placing different burdens on foreign insurance companies depending on the laws of their respective states of incorporation deny to those foreign insurance companies required to pay such additional tax the due process of law and equal protection guaranteed by Section 1 of the Fourteenth Amendment to the United States Constitution?

2. Do the California constitutional and statutory provisions granting domestic insurance companies a credit against premium taxes for the full amount of California real property taxes paid on their principal offices in the state while denying part of such credit to some but not all foreign insurance companies deny to foreign insurance companies receiving less than the full credit the due process of law and equal protection guaranteed by Section 1 of the Fourteenth Amendment to the United States Constitution?

3. Do the California constitutional and statutory tax provisions leving an additional retaliatory tax on some foreign insurance companies but not on domestic insurance companies and placing different burdens on foreign insurance companies depending on the laws of their respective states of incorporation impose a discriminatory burden on interstate commerce prohibited by Article I, Section 8, of the United States Constitution?

4. Do the California constitutional and statutory provisions granting domestic insurance companies a credit against premium taxes for the full amount of California real property taxes paid on their principal offices in the state while denying part of such credit to some but not all foreign insurance companies impose a discriminatory burden on interstate commerce prohibited by Article I, Section 8, of the United States Constitution?

TABLE OF CONTENTS

	Page
Questions Presented	1
Opinions Below	1
Grounds for Jurisdiction	2
Constitutional and Statutory Provisions	4
Statement of the Case	4
Summary of Argument	8
Argument	
I. California's System of Taxing Foreign Insurance Companies Violates the Guarantees of the Fourteenth Amendment.	14
II. California's System of Taxing Foreign Insurance Companies Imposes an Unconstitutional Burden on Interstate Commerce.	24
Conclusion	33
Statutory Appendix	1a
United States Constitution, Article I, Sec. 8, Clause 3	1a
United States Constitution, Amend. XIV, Sec. 1	1a
McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015	1a-3a
California Constitution (West Supp. 1966) Article XIII § 14-4/5(e)	3a
California Constitution (West Supp. 1964) Article XIII § 14-4/5(f)(3)	3a-4a

PREVIOUS PAGE WAS BLANK

Page

California Insurance Code (West 1972)
Section 685 ..... 4a-5a

California Revenue and Taxation Code (West 1970)
Sec. 12241 ..... 5a-6a
Sec. 12284 ..... 6a-7a
Sec. 13102 ..... 7a
Sec. 13103 ..... 7a

TABLE OF AUTHORITIES

CASES

Allied Stores of Ohio, Inc. v. *Bowers*, 358 U.S. 522 (1959) . 17

Austin v. *New Hampshire*, 420 U.S. 656 (1975) 32

Baldwin v. *G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) ..30, 31

Boston Stock Exchange v. *State Tax Commission*, 429 U.S. 318 (1977) 12, 13, 29, 30

Concordia Fire Insurance Co. v. *Illinois*, 292 U.S. 535 (1933) 17

Connecticut General Life Insurance Co. v. *Johnson*, 303 U.S. 77 (1938) 8, 14, 29

Dean Milk Company v. *Madison*, 340 U.S. 349 (1951) .. 30

Freeman v. *Hewit*, 329 U.S. 249 (1946) 27, 30

Group Life and Health Insurance Co. v. *Royal Drug Company*, 440 U.S. 205 (1979) 28

Haas & Co., Inc. v. *Russian Hill Improvement Association*, 422 U.S. 1030 (1975) 17

Hanover Fire Insurance Co. v. *Hardling*, 272 U.S. 494 (1926) 8, 14, 15

Hartford Steam Boiler Inspection & Insurance Co. v. *Harrison*, 301 U.S. 459 (1937) 17

Page

Herndon v. *Chicago, Rock Island & Pac. Ry.*, 218 U.S. 135 (1910) 19

In Re Estate of Ginochio, 43 Cal. App. 3d 412, 117 Cal. Rptr. 565 (1st Dist. 1974) 9, 17

In Re Insurance Tax cases, 160 Kan. 300, 161 P.2d 726 (1945) 11, 12, 25

Lincoln National Life Insurance Co. v. *Read*, 325 U.S. 674 (1945) 17

McLeod v. *J. E. Dilworth Co.*, 322 U.S. 327 (1944) .. 30

Paul v. *Virginia*, 75 U.S. (8 Wall.) 168 (1868) 11, 24, 25

People v. *United National Life Insurance Co.*, 66 Cal. 2d 577, 58 Cal. Rptr. 599, 427 P.2d 199 (1967) 29

Philadelphia Fire Association v. *New York*, 119 U.S. 110 (1886) 15

Power Manufacturing Co. v. *Saunders*, 274 U.S. 490 (1927) 8, 16, 18

Prudential Insurance Co. v. *Benjamin*, 328 U.S. 408 (1946) 10, 11, 12, 24, 25, 26, 27

Prudential Insurance Co. v. *Hobbs*, 328 U.S. 822 (1946) 10, 11, 12, 24, 25, 26, 27

Prudential Insurance Co. v. *Indiana*, 328 U.S. 823 (1946) .. 25

Reserve Life Insurance Co. v. *Bowers*, 175 Ohio St. 468, 196 N.E. 2d 87 (1964) 9, 10

Reserve Life Insurance Co. v. *Bowers*, 380 U.S. 959 (1965) 19

Robertson v. *California*, 328 U.S. 440 (1946) 25

Russian Hill Improvement Association v. *Board of Permit Appeals*, 44 Cal. App. 3d 138, 118 Cal. Rptr. 490, (1st Dist. 1974) 17

Page

St. Louis Allgeyer v. *Louisiana*, 165 U.S. 578 (1897) 29

St. Louis Cotton Compress Co. v. *Arkansas*, 260 U.S. 346 (1922) 29

St. Paul Fire & Marine Insurance Co. v. *Barry*, 438 U.S. 531 (1978) 28

St. Paul Fire & Marine Insurance v. *Todd Shipyards Corp.*, 370 U.S. 451 (1962) 28

Southern Railway Co. v. *Greene*, 216 U.S. 400 (1910) 8, 14, 15, 17-18, 21

State Board of Insurance v. *Todd Shipyards Corp.*, 370 U.S. 451 (1962) 12, 28, 29

United States v. *South-Eastern Underwriters Association*, 322 U.S. 533 (1944) 11, 24, 25

Western Union Telegraph Co. v. *Frear*, 216 F. 199 (W.D. Wis. 1914) 9, 18

Wheeling Steel Corp. v. *Glander*, 337 U.S. 562 (1949) 9, 19, 21

WHYY, Inc. v. *Glassboro*, 393 U.S. 117 (1968) ..9, 19, 20, 21

STATUTES

California Insurance Code, Sec. 685 ..... 2, 4

California Revenue and Taxation Code

Sec. 12241 .....3, 4, 20
Sec. 12284 ..... 2, 4
Sec. 13102 4
Sec. 13103 ..... 3, 4

McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015 .....4, 10, 24

28 U.S.C. § 1257(2) 3

Page

State Statutes:

Code of Alabama, § 27-44 (1975) 32
Alaska Statutes, § 21.09.210 (1966) 32
Arkansas Statutes, § 66-2302 (1979) 32
Hawaii Revised Statutes, § 431-318 (1978) 32
Idaho Code, § 41-402 (1977) 32
Mississippi § 27-15-103 (1977) 32
Montana Code Annotated, § 33-2-706 (1978) 32
New Mexico Statute Annotated 1978, § 59-5-1 (1979) .. 32
General Statute of North Carolina, § 150-228.5 (1974) .. 32
North Dakota Century Code, § 26-01-11 (1979) 32
Oklahoma Statutes, § 36-6-624 (1979) 32
Code of Laws of South Carolina, § 38-50320 (1980) 32
South Dakota Codified Laws, § 10-44-2 (1980) 32
Vernon's Annot. Civil Statutes/Insurance Code Title 78, Art. 4769 (1957) 32
West Virginia Code, § 33-3-14 and § 33-3-14a (1961) .. 32
Wyoming Statutes, § 26-4-103 (1977) 32

CONSTITUTIONAL PROVISIONS

California Constitution

Article XIII, Sec. 14-4/5(e) 3, 4
Article XIII, Sec. 14-4/5(f)(3) 2, 4, 20

United States Constitution

Article I, Sec. 8 ..... 3, 4, 33
Article I, Sec. 8, Clause 3 33
Amend. XIV, Sec. 1 ..... 3, 4, 23, 33

OTHER AUTHORITIES

H.R. Rep. No. 143, 79th Cong. 1st Sess. p.3 29

NO. 79-1423

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY,

Appellant,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal, Second Appellate District, State of California

BRIEF FOR THE APPELLANT

OPINIONS BELOW

The unreported Intended Decision, Memorandum of Intended Decision, Conclusions of Law and Judgment of the Superior Court of the State of California for the County of Los Angeles are printed in the Joint Appendix, beginning at page 55. The opinion of the Court of Appeal of the State of California, Second Appellate District, and the order of such Court of Appeal modifying its opinion and denying the Petition for Rehearing are printed in the Joint Appendix, beginning at page 80. The original Court of Appeal opinion before its modification in response to the Petition for Rehearing

is reported at 99 Cal. App. 3d 410, 159 Cal. Rptr. 539 (1979). The decision of the Supreme Court of California denying a hearing ("Hearing Denied.") remains unpublished, but is printed on page 89 of the Joint Appendix.

GROUNDS FOR JURISDICTION

Appellant, The Western and Southern Life Insurance Company ("Western and Southern"), appeals from the judgment of the Court of Appeal of the State of California, Second Appellate District, entered November 2, 1979, reversing the decision of the Superior Court of the State of California for the County of Los Angeles, entered October 27, 1977. A Petition for Rehearing by the Court of Appeal was filed by Western and Southern on November 19, 1979. In an order filed November 28, 1979, the Court of Appeal modified its opinion and denied rehearing. On December 11, 1979, Western and Southern filed a petition for hearing by the Supreme Court of California, which denied the petition on December 27, 1979. Notice of Appeal to this Court was filed with the Court of Appeal of the State of California, Second Appellate District, on February 11, 1980. Western and Southern's Jurisdictional Statement was filed in this Court on March 13, 1980, and probable jurisdiction was noted October 6, 1980.

Western and Southern, an insurance company incorporated in Ohio, asserts that the following actions of Appellee, The State Board of Equalization of the State of California (the "Board"), violate the Constitution of the United States.

1. The levying of retaliatory taxes upon Western and Southern for the years 1965 through 1971, under California Constitution, Article XIII, section 14-4/5(f)(3), as amended November 3, 1964 (California Constitution, West. Supp. 1964); California Insurance Code, section 685 (West 1972); and California Revenue and Taxation Code, section 12284 (West 1970).

2. The denial of a credit for the full amount of real property taxes paid on Western and Southern's principal office in California against its California premium taxes for 1966 through 1971, under California Constitution, Article XIII, section 14-4/5(e) (West Supp. 1966); and California Revenue and Taxation Code, section 12241 (West 1970).

Western and Southern paid the additional taxes under protest each year and filed claims for refund thereof. The Board denied the claims, and Western and Southern brought suit for refund in the Superior Court of Los Angeles County under authority of California Revenue and Taxation Code, section 13103.[1]

Western and Southern alleged in its complaint, and the trial court found, that the California Constitution and correlative taxing statutes levied an unconstitutional burden upon interstate commerce and discriminated against Western and Southern contrary to Section 8 of Article I and Section 1 of the Fourteenth Amendment of the United States Constitution. The Court of Appeal reversed the trial court, expressly holding that the California laws did not violate the cited provisions of the United States Constitution. The Supreme Court of California denied Western and Southern's Petition for Hearing, and the Court of Appeal decision became final on December 27, 1979. The jurisdiction of this Court therefore rests upon 28 U.S.C. § 1257(2).

---

[1] Statutory Appendix hereto, page 7a.

CONSTITUTIONAL AND STATUTORY PROVISIONS

The provisions of the United States Constitution, of the United States laws, of the California constitution and of the California laws involved in this case are the following:

U.S. Constitution, Article I, Section 8, Clause 3

U.S. Constitution, Amendment XIV, Section 1

McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015

California Constitution, Article XIII, Section 14-4/5(e)

California Constitution, Article XIII, Section 14-4/5(f)(3)

California Insurance Code, Section 685

California Revenue and Taxation Code:

Section 12241

Section 12284

Section 13102

Section 13103

These constitutional and statutory provisions are lengthy and are printed in the Statutory Appendix hereto, beginning at page 1a.

STATEMENT OF THE CASE

Western and Southern is an Ohio corporation engaged in the life insurance business. It has a Certificate of Authority to do business in California issued pursuant to California Insurance Code section 701. This certificate was issued for an indefinite term and became effective July 1, 1956. (Joint Appendix ("JA"), p. 43) Since that date Western and Southern has continually done business in California. Prior to 1965, it constructed an office building on land owned in Los Angeles, California, established its principal California office therein, and occupied it during all the years here pertinent. (Stipulation of Facts ¶ 3, JA p. 5)

From 1965 to 1971, the Board assessed against Western and Southern "retaliatory taxes" under the authority of the California Constitution, Insurance Code, and Revenue and Taxation Code. These provisions impose an additional tax on a foreign insurance company doing business in California when the state of incorporation of the foreign insurer imposes on California insurance companies doing business in the foreign state higher taxes than California imposes on insurance companies from that foreign state doing business in California. By definition, this California tax is *never* imposed on an insurance company incorporated in California, and it is imposed only on some foreign insurance companies, namely, those incorporated in states which impose greater taxes on insurers than California. Imposition of retaliatory taxes by California is not dependent upon unequal treatment of foreign and domestic insurers by the foreign state. Were it so dependent, the tax would be called an "anti-discrimination retaliatory tax" (JA p. 61) because its objective would be to discourage other states from discriminating against California insurance companies by taxing them at rates higher than they tax their own domestic insurers.

The parties have stipulated that, in the years here pertinent, Ohio did not impose a higher tax burden on California (or other foreign) insurers than it imposed on its own domestic insurers,[2] and the trial court so found.[3] But the tax burden on insurance companies, both domestic and foreign, is higher in Ohio than it is in California. Therefore, an Ohio insurance company doing business in California pays an additional pen-

---

[2] ¶ 2 of the Stipulation of Facts filed in the trial court states:

> . . . by the laws of the State of Ohio, taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions imposed upon life insurers of California analogous to plaintiff doing business in Ohio, or upon their agents therein, were not in excess of those imposed by the State of Ohio upon such insurers of Ohio or upon their agents therein. JA p. 5.

[3] ¶ 7, Conclusions of Law, JA p. 75.

alty tax to the State of California. Because this tax is based on a comparison of the tax burdens upon foreign insurers in the state of incorporation of the foreign insurer with California's tax burdens on foreign insurers, without reference to the retaliatory laws of either state, it is known as a "comparative retaliatory tax." Western and Southern brings before this Court the question of the constitutionality of California's comparative retaliatory tax.

To exacerbate Western and Southern's tax predicament, the Board also denied it full credit against its premium taxes for real property taxes paid with respect to its principal office in California for 1966 and later years under purported authority of the California Constitution and Revenue and Taxation Code. These provisions grant California insurance companies a credit against insurance premium taxes (the "principal office deduction") for the full amount of real property taxes levied on their principal offices in California without regard to the percentage of such offices occupied by the insurance companies. A similar credit is extended to foreign insurance companies which occupy 75% or more of the property comprising their principal offices in California. However, the principal office deduction for foreign insurance companies, such as Western and Southern, occupying less than 75% of their property, is limited to the percentage of such real property taxes equal to the percentage of principal office property occupied by them. Western and Southern challenges as unconstitutional the granting of a credit against premium taxes to a domestic insurer and to some foreign insurers greater than the credit granted to other foreign insurers, such as Western and Southern.

The trial court also pointed out (¶ 17, Conclusions of Law, JA p. 77) that because the retaliatory tax is computed as the difference between the total of the taxes (including premium taxes and real property taxes) already paid by the foreign insurer in California and the total tax burden on a hypothetical similar California company doing business in the foreign insurer's state of incorporation, even if the foreign

insurer were granted the full principal office deduction, the retaliatory tax would be increased by the amount of the principal office deduction credited against the premium tax, again effectively denying to the foreign insurance company the principal office deduction.

As a result of these two aspects of California's taxation of foreign insurance companies, Western and Southern was forced to pay to California $977,853.57 more in taxes for the years here in isssue than a California insurer of the same size and asset mix and doing equivalent business would have paid. After its timely claims for refund of these additional taxes were denied by the Board, Western and Southern commenced this action on May 17, 1971, by filing a complaint in the Superior Court of the State of California for the County of Los Angeles, seeking refund of the retaliatory taxes paid under protest for the years 1965 through 1969, inclusive, and premium taxes paid under protest for the years 1966 through 1969, inclusive.

By stipulation of the parties filed December 31, 1976, Western and Southern's complaint was amended to include a prayer for refund of additional retaliatory and premium taxes paid for the years 1970 and 1971, subsequent to the filing of the original complaint, and the Board's answer was extended to cover such amended complaint. (JA pp. 44-46) Also on December 31, 1976, the parties filed a Stipulation of Facts (JA pp. 3-42) which was admitted into evidence by minute order of the trial court on June 10, 1977. (R. p. 665)

The Superior Court of the State of California for the County of Los Angeles tried the case without a jury on the evidence presented in the Stipulation of Facts and, following oral argument of counsel addressed principally to the federal constitutional questions, found that both the retaliatory tax and the denial of the full credit for real property tax on its principal office violated Western and Southern's rights under the United States Constitution. (JA p. 71)

The Board appealed the Superior Court's decision to the

Court of Appeal of the State of California, Second Appellate District, on December 21, 1977, which, in its November 2, 1979, decision, reversed the lower court. (JA p. 80) This appeal followed.

SUMMARY OF ARGUMENT

I. The Fourteenth Amendment guarantees equal protection of the laws to all persons, and a corporation is a person likewise entitled to protection from arbitrary legislative action. *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77 (1938); *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926).

Once a corporation is admitted to do business within a state for an indefinite term, the state must accord the corporation equal protection under its laws during the period for which the corporation has been admitted to do business. As this Court held in *Southern Railway Co.* v. *Greene,* 216 U.S. 400 (1910), an additional tax levied by Alabama on all foreign corporations but not on domestic corporations long after the Southern Railway Company had been admitted to do business in the state for an unlimited term violated equal protection rights of the foreign corporations.

The *Southern Railway* decision was expanded in *Hanover Fire Insurance Co.* v. *Harding, supra,* where this Court held that Illinois could not force a foreign insurance corporation licensed on a year-to-year basis to waive rights secured to it by the Constitution in order to gain readmission to do business in Illinois the following year. This Court, voiding a tax on the net receipts of foreign insurers, stated that a foreign corporation, after admission to do business in a state, "stands equal with and is to be classified with domestic corporations of the same kind." 272 U.S. at 510-11. Likewise, in *Power Manufacturing Co.* v. *Saunders,* 274 U.S. 490 (1927), this Court held unconstitutional an Arkansas statute authorizing suit against a foreign corporation in any county of the state,

while requiring suits against domestic corporations to be brought in a county where the corporation had a place of business or its chief officer resided.

"Equal protection" does not preclude California from drawing reasonable distinctions between persons, but requires that persons similarly situated receive like treatment. *In re Estate of Ginochio,* 43 Cal. App. 3d 412, 117 Cal. Rptr. 565 (1st Dist. 1974). It is fundamental that the classification of corporations into domestic and foreign categories is unreasonable and violates the equal protection clause. *Western Union Telegraph Co.* v. *Frear,* 216 F. 199 (W.D. Wis. 1914).

In *Wheeling Steel Corp.* v. *Glander,* 377 U.S. 562 (1949), this Court examined an Ohio statute which provided that intangible property arising out of business transacted in Ohio by a non-resident was subject to taxation, whereas intangible property of a resident arising out of business transacted out of state was not subject to tax. This Court found that the statute violated the equal protection clause because the difference in the tax treatment was based, not on Ohio's relationship to the transactions in question, but on the differing residences of the persons engaging in the transactions.

Discriminatory taxation of a foreign life insurance corporation was struck down in *Reserve Life Insurance Co.* v. *Bowers,* 380 U.S. 258 (1965), upon the authority of the *Wheeling Steel* case. This Court invalidated an Ohio statute which levied a personal property tax on foreign, but not domestic insurance companies. More recently, a New Jersey statute was held unconstitutional based upon its classification of non-profit corporations into foreign and domestic categories for purposes of qualifying for real and personal property tax exemptions. *WHYY* v. *Glassboro,* 393 U.S. 117 (1968).

Application of the cited cases to the California system of taxing Western and Southern, an Ohio corporation, demonstrates that the system violates the equal protection guarantees of the Fourteenth Amendment. The difference in the amount

of the principal office deduction allowed to California insurers as contrasted to foreign insurers, such as Western and Southern, occupying less than 75% of their property, is based upon one fact: the state of incorporation of the insurer. It is patent that Western and Southern was subject to the same real estate taxes on its California property as a California corporation; it paid the taxes to the same governmental authority; its existence in California does not burden the state more heavily than a domestic corporation.

The same logic applies to the assessment by California of its comparative retaliatory tax, and the Board cannot justify this tax based upon discriminatory treatment of foreign insurance companies by Ohio. It is stipulated that Ohio did not impose a higher tax burden on California insurers than on its own domestic insurers.

In *Wheeling Steel,* Ohio sought to justify its resident, non-resident classification scheme by suggesting that other states whose citizens were victims of the discrimination could remedy the unfairness by adopting similarly discriminatory systems. This Court pointed out that the "offer of reciprocity" could not restore to the non-residents the equality denied by the Ohio tax on intangibles. Similarly, it is implausible to argue that Ohio is responsible for remedying the tax predicament created by California. Ohio has adopted a system of taxation which it deems to be desirable. California's system must stand or fall on its effect on insurers within its own borders. That effect is discriminatory and therefore unconstitutional. *Reserve Life Insurance Co.* v. *Bowers, supra.*

II. The trial court adopted this view and held that California's scheme of taxing foreign insurers was invalid; the Court of Appeal reversed because it believed that this Court in *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 833 (1946), and *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946), had determined that the discrimination against foreign insurers was sanctioned by the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015.

That law was passed by Congress in 1945 to preserve state regulation and taxation of insurers from attacks based upon the commerce clause following the decision by this Court in *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944), that an insurance company conducting a substantial part of its business across state lines was engaged in interstate commerce. The *South-Eastern Underwriters* decision overturned the 76-year-old precedent of *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868) and resulted in the initiation of a series of cases ultimately decided in 1946, which claimed that the commerce clause precluded the states involved from regulating a foreign insurer or from taxing it differently than a domestic company.

Only one of the series of cases, *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946), involved a retaliatory tax, that in effect in Kansas. The sole contention made with respect to such tax was that the commerce clause was violated. The Kansas Supreme Court had held, *In re Insurance Tax Cases,* 160 Kan. 300, 161 P.2d 726 (1945), that *South-Eastern Underwriters* did not render its tax void, and that Congress did not exceed its powers in passing the McCarran-Ferguson Act. This Court affirmed *per curiam,* citing as authority *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946). The *Benjamin* decision, rendered a week before *Hobbs,* dealt with the validity of a premiums tax levied on foreign insurers in the State of South Carolina. In upholding the South Carolina tax, the Court said:

> We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein. 328 U.S. at 431, n. 4.

This Court also said that it did not intend to imply that the McCarran-Ferguson Act exempted all state statutes regulating interstate insurance business from attack under the commerce clause or other constitutional criteria. *Id.* at 430.

Thus, because the Supreme Court in *Hobbs* merely affirmed in summary fashion the Kansas Supreme Court's limited holding, *Hobbs* should not be read as requiring approval of California's retaliatory tax on foreign insurers. There was no evidence of discrimination between foreign and domestic insurers in the three Kansas tax statutes in question. *In re Insurance Tax Cases,* 160 Kan. at 311, 161 P.2d at 734. The *Benjamin* decision should not be taken as a stamp of approval upon California's discriminatory retaliatory taxation of interstate commerce, first, because this Court said it was expressing no opinion regarding taxing statutes not substantially identical to the South Carolina statute under consideration, and second, because of the disclaimer that the Court did not intend wholesale approval of *all* state insurance regulations and taxes.

Western and Southern believes the California Court of Appeal incorrectly interpreted both *Hobbs* and *Benjamin.* If it did not, Western and Southern urges this Court to reexamine its earlier decisions. The legislative history of the McCarran-Ferguson Act indicates that Congress merely intended to relieve the uncertainty created by the *South-Eastern Underwriters* decision and gave the states no more powers than those they previously had. In *State Board of Insurance* v. *Todd Shipyards Corp.,* 370 U.S. 451 (1962), state taxation and regulation of insurers were held subject to the constitutional restraints imposed, *inter alia,* by the due process clause. While the commerce clause does not prohibit some state taxation of interstate insurance transactions, particularly in view of the Congressional purpose of the McCarran-Ferguson Act, both California's retaliatory tax and its refusal to grant all foreign insurers the full principal office deduction constitute such substantial and unreasonable burdens on interstate commerce that they should no longer escape the commerce clause strictures.

The basic purpose of the commerce clause is to create an area of free trade among the several states. *Boston Stock Exchange* v. *State Tax Commission,* 429 U.S. 318 (1977). In

the *Boston Stock Exchange* case, this Court held that a New York statute imposing a greater transfer tax on out-of-state securities sales than on in-state security sales violated the commerce clause. The Court stated that obstructions to competition between the states cannot be upheld, even when they are sought to be justified as measures to assure the economic health of local industry.

California's retaliatory tax discriminates against interstate commerce in preference to local industry. The tax applies only to foreign insurers incorporated in the seventeen states which place higher tax burdens upon insurers than California. (See fn. 4, infra, p. 32.) Even if the home state of the foreign insurer taxes both domestic and foreign insurers generally on an equal footing, without regard to retaliation, California imposes its punitive retaliatory tax. The tax directly obstructs interstate commerce and substantially disrupts the equilibrium of free trade among the states; it violates the commerce clause.

ARGUMENT

I. CALIFORNIA'S SYSTEM OF TAXING FOREIGN INSURANCE COMPANIES VIOLATES THE GUARANTEES OF SECTION 1 OF THE FOURTEENTH AMENDMENT.

The constitutional guarantees of "due process of law" and "equal protection of the laws" protect all persons from arbitrary legislative action, and a corporation is a person entitled to such guarantees. *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77 (1938); *Hanover Fire Insurance Co.* v. *Harding,* 272 U.S. 494 (1926).

Once a corporation is admitted to do business within a state, the state must guarantee the corporation equal protection under its laws during the period for which it has been admitted to do business. *Southern Railway Co.* v. *Greene,* 216 U.S. 400 (1910). In *Southern Railway,* the plaintiff was a foreign corporation admitted to do business in Alabama when both foreign and domestic corporations paid the same Alabama franchise taxes and fees for the privilege of engaging in business in that state. After the plaintiff had conducted business in Alabama for several years, a new and additional franchise tax was levied upon all foreign corporations within the state but not upon domestic corporations. This Court held that the imposition of such a tax violated the equal protection clause of the Fourteenth Amendment. In so holding the Court distinguished prior cases which held that a state could impose discriminatory burdens upon foreign corporations as conditions of admission to do business within the state, and noted:

> It is sufficient for the present purpose to say that we are not dealing with a corporation seeking admission to the State of Alabama, nor with one which has a limited license, which it seeks to renew, to do business in that State; nor with one which has come into the State upon

> conditions which it has since violated. In the case at bar we have a corporation which has come into and is doing business within the State of Alabama, with the permission of the State and under the sanction of its laws, and has established therein a business of a permanent character, requiring for its prosecution a large amount of fixed and permanent property, which the foreign corporation has acquired under the permission and sanction of the laws of the State. *Id.* at 413-14.

The *Southern Railway* opinion quoted from *Philadelphia Fire Association* v. *New York*, 119 U.S. 110 (1886), an apparently contradictory case, to show that the latter's holding expressly was predicated upon the facts that the state had licensed the corporation only from year to year and had retained authority to exclude it at the end of any year. 216 U.S. at 415. By contrast, it was noted that the Southern Railway Company had been admitted for an unlimited term. Therefore, Alabama's new additional tax, which was a tax more onerous to foreign corporations than to domestic corporations, violated the Fourteenth Amendment. 216 U.S. at 413-18.

A line of demarcation again was sharply drawn in *Hanover Fire Insurance Co.* v. *Harding*, 272 U.S. 494 (1926), where this Court expanded the *Southern Railway* decision. In *Hanover*, the State of Illinois attempted to enforce a tax on the net receipts of foreign insurers. This tax was not one of the conditions upon which the insurance company originally was authorized to do business in Illinois, and it did not apply to domestic insurance companies. Although Illinois required foreign insurers to renew their licenses annually, the Court held that the state could not force foreign corporations to waive a right secured to them by the Constitution of the United States by characterizing a tax as the price of readmission for the following year. The Court distinguished the imposition of such a condition to the renewal of a license from the imposition of discriminatory conditions upon foreign corporations initially seeking admission to do business in a state:

> In subjecting a law of the state which imposes a charge upon foreign corporations to the test whether such a charge violates the equal protection clause of the 14th Amendment, a line has to be drawn between the burden imposed by the state for the license or privilege to do business in the state and the tax burden which, having secured the right to do business, the foreign corporation must share with all the corporations and other taxpayers of the state. With respect to the admission fee, so to speak, which the foreign corporation must pay to become a quasi citizen of the state and entitled to equal privileges with the citizens of the state, the measure of the burden is in the discretion of the state and any inequality as between the foreign corporation and the domestic corporation in that regard does not come within the inhibition of the 14th Amendment; *but after its admission, the foreign corporation stands equal and is to be classified with domestic corporations of the same kind.* *Id.* at 510-11. (Emphasis supplied.)

Once a foreign corporation has been admitted to do business in a state, that state "may not exact as a condition to the corporation's engaging in business within its limits that its rights secured to it by the Constitution of the United States may be infringed." *Id.* at 507. To the same effect was *Power Manufacturing Co.* v. *Saunders,* 274 U.S. 490 (1927), involving a venue statute of Arkansas authorizing foreign corporations doing business in the state to be sued in any county in the state while requiring actions against domestic corporations to be brought in a county where it had a place of business or in which its chief officer resided. This Court said:

> The contention . . . that the defendant impliedly assented to the venue provisions is answered and refuted by repeated decisions holding that a foreign corporation by seeking and obtaining permission to do business in a state does not thereby become obligated to comply with or estopped from objecting to any provision in the state statutes which is in conflict with the Constitution of the United States. *Id.* at 495.

While Western and Southern's certificate of authority to do business in California specifically included the language that it was conditioned upon compliance with the laws and lawful requirements then in effect and as thereafter changed or amended, the certificate was for an indefinite term (¶ 1, Stipulation of Facts, JA p. 4), and did not require application and renewal year by year, as was the case in *Lincoln National Life Insurance Co.* v. *Read*, 325 U.S. 674 (1945).

Equal protection as preserved by the federal Constitution does not preclude California from drawing reasonable distinctions between persons, but requires that persons similarly situated receive like treatment. *In re Estate of Ginochio*, 43 Cal. App. 3d 412, 117 Cal. Rptr. 565 (1st Dist. 1974). In determining whether persons are similarly situated, legislative classification violates the equal protection standards unless the classification is based upon some difference in the classes having a substantial relation to the purpose for which the legislation is designed. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959); *Hartford Steam Boiler Inspection & Insurance Co.* v. *Harrison*, 301 U.S. 459 (1937); *Concordia Fire Insurance Co.* v. *Illinois*, 292 U.S. 535 (1933); *Russian Hill Improvement Association* v. *Board of Permit Appeals*, 44 Cal. App. 3d 138, 118 Cal. Rptr. 490 (1st Dist. 1974), *appeal dismissed sub nom. Haas & Co., Inc.* v. *Russian Hill Improvement Association*, 422 U.S. 1030 (1975). Thus, a classification violates equal protection unless it is based on a real difference between the entities classified.

The classification of corporations into foreign and domestic categories and the further subclassifications of foreign insurance companies in the California retaliatory and premiums tax provisions are unreasonable. Because they are based upon no real or substantial difference, these classifications violate the equal protection clause. A corporation does not burden the State of California more heavily merely because it is incorporated out of state or because it occupies more or less than 75% of its principal California office building. As this Court noted in *Southern Railway, supra*:

> It would be a fanciful distinction to say that there is any real difference in the burden imposed because the one is taxed for the privilege of a foreign corporation to do business in the State and the other for the right to be a corporation. *The fact is that both corporations do the same business in character and kind,* and under the statute in question a foreign corporation may be taxed many thousands of dollars for the privilege of doing, within the State, exactly the same business as the domestic corporation is permitted to do by a tax upon its privilege, amounting to only a few hundred dollars. We hold, therefore, that to tax the foreign corporation for carrying on business under the circumstances shown, by a different and much more onerous rule than is used in taxing domestic corporations for the same privilege, is a denial of the equal protection of the laws, and the plaintiff being in position to invoke the protection of the Fourteenth Amendment, that such attempted taxation under a statute of the State, does violence to the Federal Constitution. 216 U.S. at 417-18. (Emphasis supplied.)

It is well established that classification based upon a corporation's state of incorporation violates the equal protection clause. In *Western Union Telegraph Co.* v. *Frear,* 216 F. 199 (W.D. Wis. 1914), a Wisconsin statute providing that any foreign corporation which exercised its right to remove a lawsuit to a federal court forfeited its license to do business within that state was held to violate the equal protection clause:

> Any attempt to substantially discriminate between domestic corporations and foreign corporations admitted to do business in a state, prejudicial to the latter, is invalid, whether it be by unequal taxation or other substantial inequality. *Id.* at 202.

See also Power Manufacturing Co. v. *Saunders,* 274 U.S. 490 (1927), in which this Court held that the venue statute

discriminating against foreign corporations violated the equal protection clause. Similarly, in *Herndon* v. *Chicago, Rock Island & Pac. Ry.*, 218 U.S. 135, 158-59 (1910), a Missouri statute requiring a foreign railway to forfeit its right to do business in Missouri if it resorted to a federal court was held unconstitutional.

In *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949), this Court examined an Ohio statute which governed the situs for taxation of intangible property, including accounts receivable. The statute provided that intangible property arising out of business transacted in Ohio by a non-resident was subject to taxation, whereas intangible property of a resident arising out of business transacted out of state was not subject to tax. In holding the statute violative of the equal protection clause, this Court noted:

> *It seems obvious that appellants are not accorded equal treatment, and the inequality is not because of the slightest difference in Ohio's relation to the decisive transaction, but solely because of the different residence of the owner. Id.* at 572. (Emphasis supplied.)

In *Reserve Life Insurance Co.* v. *Bowers*, 380 U.S. 258 (1965), *rev'g* 175 Ohio St. 468, 196 N.E.2d 87 (1964) this Court applied *Wheeling Steel* to strike down discriminatory taxation of a foreign life insurance company. Prior to 1960, Ohio levied a personal property tax on foreign insurance companies but exempted domestic insurance companies therefrom. The insurance company alleged that the law violated the equal protection clause of the Fourteenth Amendment. This Court, citing *Wheeling Steel* as authority, reversed the Ohio Supreme Court decision and held that the law was invalid.

More recently, this Court held that a New Jersey statute exempting domestic non-profit corporations from real and personal property taxes but not similarly exempting foreign non-profit corporations constituted an unconstitutional denial of equal protection of the laws. *WHYY* v. *Glassboro*, 393 U.S. 117 (1968) (*per curiam*). Thus, unless a state which unequal-

ly taxes foreign vis-a-vis domestic corporations can justify the disparity in treatment on grounds other than that they are residents of different states, the inequality is constitutionally impermissible.

In the instant case, the Board's denial of the full amount of the principal office deduction claimed by Western and Southern falls squarely within the holding of *WHYY, supra.* By amending Article XIII, section 14-4/5, subdivision (e) of its constitution and by enacting section 12241 of its Revenue and Taxation Code, California has deprived some foreign insurers, such as Western and Southern, of the full deduction retained for other foreign insurers and domestic insurers. Prior to 1966, all insurers, both foreign and domestic, were permitted to deduct from their gross premiums tax the amount of real estate taxes paid on account of their principal offices, regardless of whether the insurers leased space therein to others.

On November 8, 1966, the California constitution was amended to limit this deduction to a portion of the total taxes paid thereon if the taxpayer occupied less than 75% of the entire property. But this limitation did not apply to all insurers. A domestic insurer licensed to do business on or before December 31, 1966, which then owned a principal office in California or which, within the following three years, began construction of a California office was entitled to deduct the full amount of real estate taxes on its principal office, even if it occupied less than 75% of the entire building. Such provisions not only discriminate between domestic and foreign insurers but also discriminate among foreign insurers dependent on whether or not more than 25% of their offices are occupied by others. *See* Cal. Constitution, Art. XIII, § 14-4/5(e) (West Supp. 1976); Cal. Rev. and Tax. Code, § 12241 (West 1970). (Statutory Appendix, pp. 3a, 5a)

Even though Western and Southern was licensed to do business prior to December 31, 1966, and had constructed its principal office on real estate which it owned prior to January

1, 1970, it was denied the right to deduct the full amount of real estate taxes attributable to that building. Had Western and Southern been a domestic corporation or occupied at least 75% of the space, the full deduction would have been permitted. The Board can no more justify such inequality of treatment than could the taxing authorities in *WHYY, supra.* Western and Southern was subject to the same real estate tax rates as a domestic corporation; it paid these taxes to the same governmental unit as would have received payment from a domestic corporation. The only distinction upon which the inequality of treatment of Western and Southern and a California company is based is that Western and Southern is incorporated under the laws of Ohio rather than under the laws of California. Since this Court's decision in *Southern Railway, supra,* such a distinction is insufficient to justify discrimination. The additional distinction between foreign corporations obviously magnifies the constitutional violations.

Precisely the same logic applies to the issues raised by the assessment of the retaliatory taxes upon Western and Southern for the years 1965 through 1971. The only reason for the assessment of the tax is that Western and Southern is incorporated under the laws of another state. It is appropriate, furthermore, to consider the issues raised by the retaliatory tax in light of comments made by this Court in *Wheeling Steel, supra.*

In *Wheeling Steel,* the Tax Commissioner of the State of Ohio sought to justify the inequality in the taxing scheme involved by arguing that other states whose citizens were the victims of the discrimination could remedy the unfairness by adopting similarly discriminatory systems. This Court stated:

> The State does not seriously deny this unequal application of its own tax but claims that reciprocity provisions of the statute reestablish equality. Those provisions therefore require scrutiny.
>
> This entire taxing plan rests on a statutory formula for fixing situs of intangible property both within and with-

out the State. . . . These intangibles "shall be considered to arise out of business transacted *in a state other than that in which the owner resides*" under certain circumstances. [Emphasis supplied.] This basic rule separates the situs of intangibles from the residence of the owner whereas it has traditionally been at such residence, though with some exceptions. The effect is that intangibles of non-resident owners are assigned a situs within the taxing reach of Ohio while those of its residents are assigned a situs without. The plan may be said to be logically consistent in that, while it draws all such intangibles of non-residents within the taxing power of Ohio, it by the same formula excludes those of residents. The exempted intangibles of residents are offered up to the taxing power of other states which may embrace this doctrine of a tax situs separate from residence. This is what is meant here by reciprocity, and the two provisions are declared inseparable; so that if the formula by which Ohio takes unto itself the accounts of nonresidents is held invalid, "such decision shall be deemed also to affect such provision as applied to property of a resident."

It is hard to see that this offer of reciprocity restores to appellants any of the equality which the application of the Ohio tax, considered alone, so obviously denies. There is no indication of a readiness by other states to copy Ohio's situs scheme so as to tax that which Ohio exempts. The proffered exchange of residents for intangible tax purposes may not commend itself as an even bargain between states. Ohio, being large, populous and highly industralized, with heavy and basic industries, may well have much more to gain from a plan the effect of which is to tax credit exports to other states, than most states would have from a privilege to tax its own exports into Ohio. In the several years that the Ohio statute has been on the books, no other state has sought to take advantage of the "reciprocity" proffer. And if it did, the equality of rates which would also be necessary to equalize the burden between nonresidents and their resident competitors could be hardly expected nor is it provided for. 337 U.S. at 572-74.

It is no more plausible to justify California's assessment of a retaliatory tax with the argument that the State of Ohio may remedy the inequality by altering its system for the taxation of foreign insurers. Ohio has adopted a system of taxation which it deems to be desirable. Ohio's system may differ from that of California, but the California retaliatory tax must either stand or fall on its effects on insurers doing business within its borders. California cannot force its system on the State of Ohio in order to achieve "equality" any more than Ohio could force its system on the State of California in reversed circumstances. Further, what the Ohio legislature enacts is in no way the action of Western and Southern, and Western and Southern should not be penalized by the California legislature because of Ohio's statutes.

Western and Southern submits that both the comparative retaliatory tax and the denial of the principal office deduction in its full amount violate Section 1 of the Fourteenth Amendment to the Constitution.

II. CALIFORNIA'S SYSTEM OF TAXING FOREIGN INSURANCE COMPANIES IMPOSES AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

There can be no question but that the California retaliatory tax discriminates against foreign insurance companies and their interstate business, and provides a direct commercial advantage to domestic insurance companies, i.e., to local business. It is obviously intended to have such effect. The trial court stated:

> This California tax is plainly discriminatory against interstate commerce. . . . It provides a direct commercial advantage to domestic business at the expense of out-of-state business. (JA p. 65)

The court's conclusions of law held in part:

> The California retaliatory tax as effective for the years 1965 and following discriminates against insurers from other states, including Ohio . . . . (JA p. 75)

The Court of Appeal of the State of California reversed the trial court, not because it found the California retaliatory tax provisions to be free from discrimination against foreign insurers, but because it believed that this Court, in *Prudential Insurance Co.* v. *Benjamin,* 328 U.S. 408 (1946) and *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946) had determined that such discrimination was sanctioned by the McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-1015. The Court of Appeal was in error.

In 1944 this Court reversed its 76 year precedent, *Paul* v. *Virginia,* 75 U.S. (8 Wall.) 168 (1868), and held that an insurance company that conducted a substantial part of its business across state lines was engaged in interstate commerce. *United States* v. *South-Eastern Underwriters Association,* 322 U.S. 533 (1944).

To preserve state regulation of insurers from attacks based upon the commerce clause and to exempt the insurance business from certain parts of the anti-trust laws, Congress in 1945 enacted the McCarran Act. The Act declared that:

> . . . the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. 15 U.S.C. § 1011 (1976).

Following *South-Eastern Underwriters* a series of test cases was commenced. Each insurer involved claimed that, notwithstanding the McCarran Act, the reversal of *Paul* v. *Virginia* required a finding that the commerce clause precluded a state from regulating a foreign insurer at all or from taxing it on a basis other than that of a domestic insurer. *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946); *Prudential Insurance Co.* v. *Hobbs*, 328 U.S. 822 (1946) (Kansas, involving 16 different insurance companies); *Prudential Insurance Co.* v. *Indiana*, 328 U.S. 823 (1946); *Robertson* v. *California*, 328 U.S. 440 (1946). None of these cases other than the Kansas case, *Hobbs*, involved a retaliatory tax statute.

Hobbs involved three Kansas taxes imposed on the foreign insurer: a firemen's relief fund tax, a premiums tax, and a retaliatory tax. As in the other cases, however, the sole contention made below in respect to each was that the commerce clause was violated and that *South-Eastern Underwriters* rendered prior decisions "obsolete". *In re Insurance Tax Cases*, 160 Kan. 300, 305, 161 P.2d 726, 731 (1945).

In its opinion, the Supreme Court of Kansas carefully pointed out that these laws were enacted prior to 1871, 160 Kan. at 303, 161 P.2d at 730, and significantly declared:

> When each of the plaintiffs was admitted to do business in this state it either specifically or in legal effect

> agreed to be bound by the laws of the state respecting its business. 160 Kan. at 309, 161 P.2d at 733.

Not a single company subject to the retaliatory tax had been admitted in Kansas prior to its enactment. The one insurer admitted in 1871 was shown not to have been subject to any retaliatory tax and to have agreed to be bound by the record of the others.

The Kansas Supreme Court provided its own syllabus of its decision, as follows:

1. Our statutes pertaining to insurance, G.S. 1935, 40-252, subd. B, 40-170, and G.S. 1943 Supp. 40-1702 and 40-173 were not rendered void by the decision of the Supreme Court of the United States in United States v. Southeastern Underwriters Ass'n, 322 U.S. 534, 64 S. Ct. 1162, 88 L.Ed. 1440.
2. Congress did not exceed its powers in passing Public Law No. 15 of the 79th Congress, first session, 15 U.S.C.A. § 1011 et seq.
3. Mandamus will not be allowed to compel an executive officer to do something contrary to a statute unless it is clear that the statute is void.

The memorandum opinion issued by this Court, *Prudential Insurance Co.* v. *Hobbs,* 328 U.S. 822 (1946), could do no more than affirm the foregoing propositions of law. In affirming, this Court cited as authority the *Benjamin* opinion, issued one week earlier, in which this Court had cautioned:

> We express no opinion concerning the validity of any feature of these statutes not substantially identical with those of the South Carolina tax dealt with herein. 328 U.S. at 431, n. 40.

This language expressly excluded approval of the retaliatory tax in *Hobbs,* for there was no retaliatory tax in South Carolina. Furthermore it should be noted that the Kansas Supreme Court was unable to find in the record before it any evidence that foreign insurers were taxed more heavily than domestic

insurers. 160 Kan. at 311, 161 P.2d at 734. Thus, even though retaliatory taxes were hypothetically before the Court in *Hobbs*, the blatantly discriminatory brand presented by the case at bar has never been expressly considered by this Court.

In *Benjamin*, this Court said that in enacting the McCarran Act Congress intended to give its full support to existing and future state systems for regulating and taxing the business of insurance, but "Congress had no purpose to validate unconstitutional provisions of state laws . . . ." 328 U.S. at 430. Further the Court pointed out that it did not intend to imply that the McCarran Act would exempt all state statutes regulating the insurance business from attack under the commerce clause. The Court noted at page 430:

> Nor is it necessary to conclude that Congress, by enacting the McCarran Act, sought to validate every existing state regulation or tax. For in all that mass of legislation must have lain some provisions which may have been subject to serious question *on the score of other constitutional limitations in addition to commerce clause objections* arising in the dormancy of Congress' power. And we agree with Prudential that there can be no inference that Congress intended to circumvent constitutional limitations on its own power. (Emphasis supplied.)

The trial court in this case expressed the same thought in its analysis of the limits of state authority in its Memorandum of Intended Decision. (JA pp. 61-63) Following *Benjamin*, the Court decided *Freeman* v. *Hewit*, 329 U.S. 249 (1946), specifically holding that the commerce clause itself inherently limits the legislative power of the states to discriminate against interstate commerce. *Id.* at 252.

In any event, this Court is the final arbiter of the meaning and effect of its prior decisions. Western and Southern believes that *Benjamin* and *Hobbs* were interpreted incorrectly by the California Court of Appeal. If, however, such belief is in error, Western and Southern urges a re-examination of these cases and a determination by this Court that the Mc-

Carran-Ferguson Act does not authorize discriminatory taxation against interstate commerce in denial of equal protection of the laws. As the Solicitor General stated in his brief for the United States as Amicus Curiae filed July 28, 1980, the Act should not be so construed. Citing the legislative history of the Act to the effect that the states were given no more powers than those they previously had, the Solicitor General said:

> . . . There is nothing explicit in the debate, the committee reports, or the statute that suggests that the states were given authority to erect barriers of economic protectionism. Insofar as state taxes were concerned, Congress was aware that current state revenues were in jeopardy of interruption, and intended to remove that hazard and uncertainty. Nothing suggests that Congress ever considered, or that the states were in fact given, enhanced authority to exclude, or to interfere with, competition by out-of-state insurers. And this Court's decisions under the McCarran-Ferguson Act have not in other respects construed the Act to sanction anticompetitive arrangements.[10] There is no reason why the tax provisions should be construed to permit anticompetitive taxation that discriminates against out-of-state insurers.

---

[10] See, e.g., *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531 (1978).

In 1962 this Court held that state regulation and taxation of insurers must be maintained within the parameters of a trilogy of Supreme Court cases decided prior to the McCarran Act. *State Board of Insurance* v. *Todd Shipyards Corp.*, 370 U.S. 451 (1962). The Court relied upon the following legislative history of the Act to circumscribe state power:

> "It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the de-

> cision of the United States Supreme Court in the *Southeastern Underwriters Association case.* Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as, for instance, in *Allgeyer* v. *Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co.* v. *Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co.* v. *Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way." H. R. Rep. No. 143, 79th Cong., 1st Sess., p. 3. *Id.* at 455-56.

In the aforementioned cases, this Court expressly subjected state taxation and regulation of insurers to constitutional restraints imposed, *inter alia,* by the due process clause. *State Board of Insurance* v. *Todd Shipyards Corp., supra; People* v. *United National Life Insurance Co.,* 66 Cal.2d 577, 58 Cal. Rptr. 599, 427 P.2d 199, *appeal dismissed,* 389 U.S. 330 (1967).

While the commerce clause does not prohibit some state taxation of interstate insurance transactions, particularly in view of the stated congressional policy of the McCarran Act, both California's retaliatory tax and California's refusal to grant all foreign insurers the full principal office deduction constitute such substantial and unreasonable burdens on interstate commerce that they no longer can escape the commerce clause strictures.

The prohibition against discriminatory treatment of interstate commerce flows inexorably from the basic purpose of the commerce clause, to create an area of free trade among the several states. *Boston Stock Exchange* v. *State Tax Commission,* 429 U.S. 318, 328 (1977). To countenance state statutes such as the California retaliatory tax and prin-

cipal office deduction provisions that favor local enterprises at the expense of foreign corporations "would invite a multiplication of preferential trade areas destructive" of the free trade which the commerce clause protects. *See id.* at 329, *citing Dean Milk Company* v. *Madison*, 340 U.S. 349, 356 (1951).

In *Boston Stock Exchange* v. *State Tax Commission, supra*, this Court held that a New York statute imposing a greater transfer tax on out-of-state securities sales than on in-state securities sales violated the commerce clause. In so holding, the Court reaffirmed and strengthened earlier decisions holding free trade and open commerce between the states to be a basic guarantee of the commerce clause:

> [W]e begin with the principle that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod* v. *J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944). It is now established beyond dispute that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States. . . . [T]he Commerce Clause even without implementing legislation by Congress is a limitation on the power of the States." *Freeman* v. *Hewit*, 329 U.S. 249, 252 (1946). 429 U.S. at 317.

In declaring the New York statute violative of the commerce clause, the Supreme Court cited *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), a price regulation case in which it was held that the commerce clause prohibits obstructions to competition between the states, even when such obstructions are sought to be justified as measures to assure the economic health of local industry. The Court found Justice Cardozo's opinion in *Baldwin* "particularly relevant" inasmuch as it expressly rejected the argument that obstructions to competition in interstate commerce may be justified as assurances of the health of local industry:

> The Constitution was framed . . . upon the theory that the peoples of the several states must sink or swim together,

and that in the long run prosperity and salvation are in union and not division. 429 U.S. at 335-36 (citing *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 522-23 (1935)).

The constitutional infirmity of California's retaliatory tax is patent. By definition, the tax applies only to some and not all foreign insurance companies doing business in California. On its face it discriminates against the companies of some of California's sister states. Moreover, the tax lacks even a vestige of a legitimate purpose. Prior to the 1964 constitutional amendment, the tax bore a semblance of justification in that it operated only against foreign insurers whose states of incorporation (without regard to the retaliatory tax statutes of such states) taxed California insurers and other foreign insurers doing business therein on a less favorable basis than applicable to their domestic insurers. Subsequent to the amendment, however, no semblance of justification remains. Even if the home state of the foreign insurer taxes both its domestic and foreign insurers generally on an equal footing, without regard to retaliation, California would impose a punitive retaliatory tax upon a foreign insurer from such state doing business in California if the foreign insurer's state would tax a hypothetical California insurer doing business therein an amount which exceeds California's taxes on the foreign insurer doing business in California. California's retaliatory tax falls short of the substantially evenhanded treatment required by the commerce clause.

It may well be that California's comparative retaliatory tax was enacted, not for the purpose of raising revenue, but for the purpose of inducing other states not to levy higher taxes on insurance business than California levies. But as is evident here, when the State of Ohio did not accept the invitation of California and laid a heavier burden on insurance companies than California did, the direct result in the years involved was the raising of $977,853.53 in additional taxes from Western and Southern. Sixteen states in addition to Ohio levy

premium taxes on foreign insurance companies at rates higher than California's 2.35% rate.[4]

The constitutionality of one state's statutes affecting nonresidents cannot depend upon the present configuration of the statutes of another state. *Austin* v. *New Hampshire,* 420 U.S. 656 (1975). The fact that Ohio possibly could shield its resident (domestic) insurers from California's retaliatory tax by decreasing the aggregate taxes on foreign insurers generally does not salvage California's retaliatory tax provisions.[5] In fact, the discrimination is compounded, rather than cured, by retaliation. *Id.* at 666-67. California's retaliation invites counter-retaliation by the Ohio legislature and by all other states; it perpetuates and strengthens the preferential trade areas which the commerce clause was intended to eliminate.

California's purported justification of the retaliatory tax as a measure to assure the economic strength of its domestic insurers in foreign states does not withstand scrutiny. Because

---

[4] Alabama: 3.0%, Code of Alabama, § 27-44 (1975); Alaska: 3.0%, Alaska Statutes, § 21.09.210 (1966); Arkansas: 2.5%, Arkansas Statutes, § 66-2302 (1979); Hawaii: 3.197%, Hawaii Revised Statutes, § 431-318 (1978); Idaho: 3.0%, Idaho Code, § 41-402 (1977); Mississippi: 3.0%, § 27-15-103 (1977); Montana: 2.75%, Montana Code Annotated, § 33-2-706 (1978); New Mexico: 2.5%, New Mexico Statute Annotated 1978, § 59-5-1 (1979); North Carolina: 2.5%, General Statute of North Carolina, § 105-228.5 (1974); North Dakota: 2.5%, North Dakota Century Code, § 26-01-11 (1979); Oklahoma: 4.0%, Oklahoma Statutes, § 36-6-624 (1979); South Carolina: 3.0%, Code of Laws of South Carolina, § 38-5-320 (1980); South Dakota: 2.5%, South Dakota Codified Laws, § 10-44-2 (1980); Texas: 3.3%, Vernon's Annot. Civil Statutes/Insurance Code Title 78, Art. 4769 (1957); West Virginia: 3.0%, West Virginia Code, § 33-3-14 and § 33-3-14a (1961); Wyoming: 2.5%, Wyoming Statutes, § 26-4-103 (1977).

[5] If Ohio were to reduce its tax on foreign insurers but not on domestic insurers, its domestic insurers might avoid the imposition of retaliatory taxes under either an anti-discrimination or a comparative retaliatory tax statute, but this could well constitute reverse discrimination in Ohio against domestic insurers, as repugnant as the discrimination resulting from California's retaliatory tax provisions.

the tax directly obstructs interstate competition and substantially disrupts the equilibrium of free trade among the states, it violates the commerce clause.

CONCLUSION

Each of the grounds advanced herein independently supports Western and Southern's right to reversal of the Court of Appeal's decision, as the trial court found originally. (Memorandum of Intended Decision, JA, p. 57) Western and Southern was admitted for an unlimited term to do business in California. It was entitled to the equal protection and due process guarantees of the United States and California constitutions. The discriminatory tax treatment imposed upon Western and Southern with respect to the California retaliatory tax provisions and the denial of the credit for the full amount of real estate taxes on the principal office is predicated upon no substantial difference in law or in fact between foreign and domestic corporations. Accordingly, the subject tax provisions as applied to Western and Southern violate Section 8, clause 3, of Article I and Section 1 of the Fourteenth Amendment of the United States Constitution.

The judgment of the Court of Appeal of the State of California, Second Appellate District, should be reversed, and the judgment of the Superior Court of California for the County of Los Angeles should be reinstated.

Respectfully submitted,

ALAN R. VOGELER
Attorney for Appellant,
The Western and Southern
Life Insurance Company

OF COUNSEL:
Barbara G. Watts
Frost & Jacobs

November 14, 1980

STATUTORY APPENDIX

United States Constitution, Article I, Sec. 8, Clause 3:

> The Congress shall have Power . . . [cl. 3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes; . . .

United States Constitution, Amend. XIV, Sec. 1:

> Section 1
>
> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

McCARRAN-FERGUSON INSURANCE REGULATION ACT, 15 U.S.C. § 1011-1015:

§ 1011. Declaration of policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 1013. Suspension until June 30, 1948, of application of certain Federal laws; Sherman Antitrust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 1014. Applicability of National Labor Relations Act and Fair Labor Standards Act of 1938

Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

§ 1015. Definition of "State"

As used in this chapter, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.

California Constitution, Article XIII, § 14-4/5(e):

Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this State. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

Where as a result of merger, consolidation, or other method of acquisition of substantially all of the assets of one or more insurers by another insurer, effected prior to January 1, 1939, an insurer owns more than one parcel of real property in this State in which was located a home office or principal office of an insurer immediately prior to such acquisition, the owner shall designate one of such properties as its home or principal office. Real estate taxes paid by it in any of the years 1943 to 1952, inclusive, before, or within 30 days after, becoming delinquent, on such property owned by it at the time of payment and not so designated may also be deducted from the annual tax imposed by this section in respect to such year and are included within the deduction provided for in this subdivision.

California Constitution, Article XIII, § 14-4/5(f):

The tax imposed on insurers by this section is in lieu of all other taxes and licenses, state, county, and municipal, upon such insurers and their property, except:

(1) Taxes upon their real estate.

(2) That an insurer transacting title insurance in this State which has a trust department or does a trust business under the banking laws of this State is subject to taxation with respect to such trust department or trust business to the same extent and in the same manner as trust companies and the trust departments of banks doing business in this State.

(3) When by the laws of any other state or country any taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions are imposed on insurers of this State doing business in such other state or country, or upon their agents therein, in excess of those imposed upon insurers of such other state or country or upon their agents therein, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurers of such other state or country doing business in this State, or upon their agents herein.

(4) The tax on ocean marine insurance.

(5) Motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the State upon vehicles, motor vehicles or the operation thereof.

California Insurance Code, § 685:

Imposition of retaliatory taxes, licenses, fees, fines, penalties or deposit requirements.

When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in ex-

cess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State, so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this article. (Added by Stats. 1959, c. 2120, p. 4945, § 1.)

California Revenue and Taxation Code, § 12241:

Real estate taxes on principal office realty

(a) Each insurer shall have the right to deduct from the tax imposed by this chapter upon an insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this state. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for convenient use and occupation thereof.

(b) In the event a portion of the real property described in subdivision (a) is occupied by a person or persons other

than the insurer the deduction granted the insurer by said subdivision shall be limited to that percentage not to exceed 100 percent, equal to the sum of (i) the percentage of occupancy of the insurer obtained by deducting from 100 percent the ratio that the square footage of said building or buildings occupied by the person or persons other than the insurer bears to the total square footage of said building or buildings plus (ii) the lesser of one-half of said percent of occupancy of the insurer or 25 percent, provided, however, that the limitation set forth in this paragraph shall not be applicable to such real property occupied by a domestic insurer as its home office or principal office in this state on January 1, 1970, or to such real property upon which construction of the home office or principal office of the domestic insurer commenced prior to January 1, 1970. As used in this section, "domestic insurer" means an insurer organized under the laws of this state and licensed to transact insurance in this state on or before December 31, 1966.

(c) The phrase "person or persons other than the insurer" as used in subdivision (b) of this section shall not include (i) another insurance company or association affiliated directly or indirectly with the insurer through direct ownership or common ownership or control; or (ii) the corporate or other manager of the insurer to the extent of its insurance management activities.

(Added by Stats, 1961, c. 740, p. 1983, § 28, operative Jan. 1, 1962. Amended by Stats, 1967, c. 1007, p. 2600, § 4.)

California Revenue and Taxation Code, § 12284:

Assessment; notice.

Annually, on or before September 15th, the board shall assess in respect to the preceding calendar year, the retaliatory taxes imposed upon insurers, giving consideration to the recommendations of the Insurance Commissioner. Immediately after making the assessment of retaliatory tax against an

insurer, the board shall give notice of the assessment to the insurer at its address as it appears in the records of the board. The board shall transmit copies of the notice to the Insurance Commissioner and the Controller.

(Added by Stats. 1961, c. 44, p. 985, § 1, eff. March 31, 1961.)

California Revenue and Taxation Code, § 13102:

Necessity of claim for refund or credit.

No suit or proceeding shall be maintained in any court for the recovery of any amount alleged to have been erroneously or illegally assessed or collected unless a claim for refund or credit has been duly filed in accordance with Article 2 of Chapter 7 of this part.[1]

(Added by Stats. 1961, c. 740, p. 1992, § 70, operative Jan. 1, 1962.)

California Revenue and Taxation Code, § 13103:

Action against board after notice of board's action on claim for refund or credit.

Within 90 days after the mailing of the notice of the board's action upon a claim for refund or credit, the claimant may bring an action against the board on the grounds set forth in the claim in a court of competent jurisdiction in any county or city and county in the State in which the Attorney General has an office for the recovery of the whole or any part of the amount with respect to which the claim has been disallowed. The Attorney General shall defend the action.
(Added by Stats. 1961, c. 740, p. 1992, § 72, operative Jan. 1, 1962.)

---

[1] Section 12977 et seq.